

3rd Annual Regional Energy Regulatory Conference for Central/Eastern Europe & Eurasia

**December 7 – 9, 1999
Budapest, Hungary**

Co-hosted by the Hungarian Energy Office

Series of Licensing Related Issue Papers

- **The Most Important Legal/Statutory Elements for Regulation of the Energy Sector**
- **Amendments to Energy Licenses Initiated by the Regulator**
- **Regulatory Actions to Limit or Correct Abuse of Market Power**
- **Limits on the Scope of Issues Within the Authority of Energy Regulators**

Prepared by

Licensing/Competition Committee:

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Issue Papers Licensing/Competition Committee

Prepared by
Licensing/Competition Committee Members

In Consultation with
Hagler Bailly

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3rd Annual Regional Energy Regulatory Conference for Central/Eastern Europe and Eurasia

December 1999

Dear Colleague:

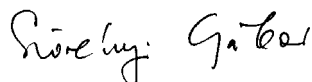
As Chairman of the Licensing/Competition Committee of the 1st, 2nd and 3rd Annual Energy Regulatory Conference for Central/Eastern Europe and Eurasia, I am pleased to present, after the first five papers in 1998, the second block of papers in a series on licensing energy activities in nations with transitional economies. Created in November 1997, the Licensing Committee, transformed into the Licensing/Competition Committee in December 1998, is a component of the USAID sponsored regulatory network that has been designed to encourage information sharing between newly established energy regulatory commissions in the region.

During the past year, committee members from Armenia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Poland, Romania, Russia and Ukraine, met on two occasions in 1999 to discuss licensing issues that are specific to the region and to nations with transitional economies. The enclosed papers represent the Committee's consensus on licensing, monitoring in the Central/Eastern European and Eurasian region and, with the recommendations they contain, provide an authoritative guide on the subject for newly established regulatory commissions and their regulated utilities. They demonstrate both theoretical aspects and practical strategies related to licensing and monitoring to help new regulators through the licensing and monitoring processes.

We hope that our work is a beginning. The enthusiastic consensus of our Committee proves these co-operative efforts are invaluable. Coming together to work out questions of common interest is a vitally useful tool that has increased in value over time.

I would like to thank all the participating members of the Licensing/Competition Committee, USAID, the United States National Association of Regulatory Utility Commissioners and Hagler Bailly for the support provided in developing the papers. I look forward to continuing our collaboration over the next year.

Sincerely,



Dr. Gábor Szörényi

Deputy Director, Hungarian Energy Office
and
Chair of the Licensing/Competition Committee

REGIONAL ENERGY REGULATORY CONFERENCE FOR CENTRAL/EASTERN EUROPE & EURASIA

**The Most Important Legal/Statutory Elements
for Regulation of the Energy Sector**

December 1999

Licensing/Competition Committee Member Countries:

Armenia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic,
Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, and
Ukraine

The Most Important Legal/Statutory Elements for Regulation of the Energy Sector

1. INTRODUCTION

- 1.1. Regulatory authority depends on having a sufficient legal basis for the regulator's actions embedded clearly in statutory law.

This paper examines and identifies the most critical statutory powers which need to be adopted by State authorities under law in order to create an effective, independent (autonomous) regulator for the energy sector.

2. STATUTORY PROVISIONS OF GREATEST IMPORTANCE

- 2.1. To clarify the policy role of the State as separate from the authorities granted to the Regulator.
- 2.2. To establish the State's general policy objectives which guide the actions of the energy regulator:
- a) To assure adequate, safe, continuous and reliable service;
 - b) To require licensees¹ to operate efficiently at lowest reasonable costs;
 - c) To encourage the establishment and the operation of competitive markets to the maximum feasible extent;
 - d) To protect the interests of energy consumers;
 - e) To make service available to all citizens;
 - f) To encourage sufficient investments in the energy sector to provide adequate, reliable service to consumers;
 - g) To maintain the financial integrity of the energy sector;
 - h) To require a preparation and introduction of a transparent regulatory regime that includes opportunities for broad participation by interested parties and the public press and press in an open decision making process consistent with practical constraints.
 - i) To provide energy policy guidelines;
 - j) To encourage the development of sustainable technologies;
 - k) To provide guidance on environmental policy.
- 2.3. To establish an independent (autonomous) energy regulatory agency, which should balance the interests of the customers, investors and at the same time to consider the government's energy policy matters in order to secure the long-term stability and predictability of the decision making process.

¹ See Licensing Committee paper "*Elementary Elements of Licensing*" December, 1998.

- a) Agency directors are named for fixed and relatively long terms of office with removal only for incapacity (health), failure to perform duties, criminal conviction, ethical conflicts² and the like, not because decisions reached are unpopular or are opposed by the State;
- b) Administrative body composed of an odd number of directors with staggered terms of office and all with equal votes on matters of regulation [Agency head may have greater administrative authority];
- c) Agency budget subject to State revision and appropriate oversight but organization and administration left to the Agency;
- d) Regulatory fees set by Regulator and collected from licensees in amounts equal to annual budget, with reconciliation and transparent accountability (no dependency of state budget).
- e) The decision and resolutions of the Regulator can be appealed only in court, and no ministry or state agency has any authority to reconsider or reverse the decisions of the Regulator.

All above listed elements are also self-control measures of the government demonstrating that the long-term interests of the consumers and investors will not be harmed by short-term political decisions.

2.4. To require energy licenses and to authorize the Regulator:

- a) To issues licenses for all energy sector functions (if it is appropriate) and [in some countries] construction of new facilities;
- b) To establish license application and issuance procedures, based on Regulator's evaluation of the license application;
- c) To define license conditions and term of license³;
 - Regulator authorized to amend license conditions;
 - Regulator authorized to withdraw or terminate the license;
 - To issue resolutions which are binding on licensees.
- d) To impose regulatory accounting and information reporting requirements and standards on licensees;
 - Regulators need to establish effective data collection and analysis systems to provide for the continued monitoring of the financial, technical and service performance⁴ of licensees on a continuing basis.
- e) To impose fines and penalties on licensees for violation of license conditions;⁵

² Ethical conflict means the conflict of personal interests with the required conduct of the regulatory agency.

³ See Licensing Committee paper "Capacity Limits in Licenses and Licensing Period", December 1998.

⁴ See Licensing Committee paper "Financial Qualifications and Creditworthiness of License Holders for New and Existing Utilities", December 1998.

⁵ See Licensing Committee paper "License Enforcement", December 1998.

- f) To monitor activities of Licensee⁶;
 - In addition to accounting and financial reporting, the regulator needs the authority to monitor the operating performance of licensees, including compliance with any regulatory codes established and approved by the Regulator to promote good performance and protect the interests and rights of consumers.
 - g) To approve (if it is appropriate) the sale or disposition of significant assets or the union or merger of the licensee with another entity, particularly with respect to concerns about issues of competition and monopoly behavior (if necessary, in conjunction with the Competition Office).
- 2.5. To authorize the Regulator to establish the methodology for determining tariffs (consistent with the principles established in law) and to set and/or approve energy tariffs.
- a) Here it is important that the law gives the Regulator overall guidance, but not specific methods, for establishing prices since this is a matter best left to regulatory expertise and good judgment over time.
 - b) In order to promote energy sector investments, it is important that the law give recognition to the general principle that prices should be adequate to permit an efficient operator to recover all “just and reasonable” costs, including a return on invested capital commensurate with market risk.
- 2.6. To establish the general industry framework and, particularly, the principles governing energy markets;
- a) Within the established legal framework, the Regulatory should be authorized to approve the specific rules which will govern licensees’ behavior, including:
 - Market Rules;
 - Dispatch operating procedures;
 - Transmission/Distribution Grid Code;
 - Supply conduct rules
 - b) Within the market framework, the Regulator’s job is to promote and protect competition and monitor market activity to assure that entities do not obtain or use their market power to increase prices, to reduce supply quality, or to engage in unfair competition .
- 2.7. To take measures to ensure protection of “captured”⁷ consumers.
- a) Customer connection procedures;
 - b) Billing and termination procedures;
 - c) Service quality standards.⁸

⁶ See Licensing Committee paper “*Monitoring*”, December 1998.

⁷ “captured” consumer means those entities that do not have a choice of suppliers.

- 2.8. To establish a dispute resolution framework defining the role of the Regulator in resolving conflicts involving licensees, consumers, the Regulator or other parties.

3. KEY ISSUES

- 3.1. In order for the energy regulator to be effective, its fundamental authorities (rights and duties) and the licensing and market framework (principles) need to be embedded in statutory law.
- 3.2. Existing laws which conflict with the Regulator's proper authorities and oversight of licensees need to be amended or replaced with new legislation.
- 3.3. Regulators should support efforts to enact laws to implement financial reform and accountability generally in all economic activities (e.g., commercial codes, banking and accounting reforms), since the energy sector is an important beneficiary of such reforms.
- 3.4. Once the basic regulatory law is in place, Regulators must guard against the enactment of subsequent laws which conflict with the energy sector structure and regulatory framework.
- 3.5. Energy regulators need to obtain the assistance of State ministries and officials to recognize and support their essential regulatory activities.
- 3.6. For regulation to be effective all licensees need to be subject to regular data collection and monitoring of financial and operating performance by regulators through specific conditions included in energy sector licenses, as authorized by statute.
- 3.7. The Regulators should maintain a continuous discussion with the governmental bodies and with the relevant groups of legislators in order to inform them about regulatory goals and to introduce them to the possibility of implementing new regulatory models, to suggest new legislative actions, and to be familiar with the political arguments or proposals which could have either a positive or negative impact on energy regulation

4. ACTION STEPS

- 4.1. New laws should be enacted, or existing laws should be modified, to establish the energy regulator as an independent (autonomous) State agency, to establish the license, market and regulatory framework and to give regulators the authority they need to implement the provisions contained in the law and enforce the license conditions and regulatory rules which control the actions of licensees.

⁸ In many CEE/NIS countries these standards were set historically by the Ministry of Energy; this authority needs to be transferred to the new energy regulators (there are similar transition problems in other areas that should become the responsibility of energy regulators).

- 4.2. In order to obtain new or amended law that establishes the right conditions for a robust energy industry and regulatory agency:
- a) Prepare clear position papers on the basic industry and market framework objectives, the essential role of regulation and the reasons why particular legal provisions promote these objectives and others do not.
 - b) Develop a continuing information program to distribute the position papers developed in order to explain the market and regulatory framework to State officials, industry representatives, key opinion leaders, the public and press.
 - c) Prepare and promote draft legislation, including new laws and/or modifications to existing law, to establish the right conditions for a robust energy industry and regulatory agency.

REGIONAL ENERGY REGULATORY CONFERENCE FOR CENTRAL/EASTERN EUROPE & EURASIA

Amendments to Energy Licenses Initiated by the Regulator

December 1999

Licensing/Competition Committee Member Countries:

Armenia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic,
Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, and
Ukraine

Amendments to Energy Licenses Initiated by the Regulator

1. INTRODUCTION

- 1.1 In order to attract private investment to the energy sector and to keep costs as low as reasonably possible, it is important to provide a stable, rule-based and predictable legal and commercial environment.
- 1.2 One of the most important means to accomplish this goal is through energy licenses⁹ which clearly state the most important elements of the obligations of the company, the extent of regulatory oversight and the rights granted to the company.
- 1.3 Once established, it is important that changes to license conditions be introduced only in exceptional circumstances when the Regulator determines that the initial balance struck between company and consumers has changed to such an extent that amending the license is absolutely required. This can occur with the passage of time or the introduction of new facts not considered previously.
- 1.4 The introduction of changes in the basic legal framework, such as new restrictions on licensee's activities, could also require amendments to licenses.
- 1.5 Amendments may be required whenever the Regulator determines that its fundamental responsibility to guard the rights of both consumers and licensees would be severely compromised unless some action were taken to respond to changed circumstances.
- 1.6 The fact that over time the newly established Regulators become more familiar with different regulatory tools is generally not an acceptable reason to amend the license and to implement new regulatory requirements, except for cases when it is agreed with the licensees.

2. AMENDMENT OF LICENSES

- 2.1 Every effort should be made to create license documents which are clear, comprehensive and complete with a view toward limiting the future need for changes to only those matters which license conditions explicitly identify as subject to change or those events which cannot be foreseen at the time of license issuance.
- 2.2 This principle is key to providing greater certainty to private investors and, therefore, to attracting investments in the energy sector. Such investors, and their financial partners, will be committing significant amounts of capital to purchase or lease State-owned companies and for system rehabilitation and expansion over time. Regulators that provide a stable environment, one that is rule-based,

⁹ See Licensing Committee paper "*Elementary Elements of Licensing*", December 1998.

predictable and avoids unexpected changes, will be more likely to succeed in attracting strategic investments initially and, since an important component of the cost of capital is attached to “regulatory risk”, stability means lower energy prices as well.

- 2.3 The Regulator may initiate a license modification, if the circumstances which existed at the time of issuing the license, have changed significantly, such as:
- a) The operating model (framework) of the electric industry changes extensively in ways that make license amendments necessary;
 - b) The licensee seriously violates the license provisions[and other remedies are ineffective or inadequate to correct the problem]¹⁰ ;
 - c) The licensee changes its name, form of business (Ltd. Joint-stock Co.), or amount of capital [mostly administrative issues only];
 - d) The existing license is in conflict with the provisions of an amended Energy Law [or other statute];
- 2.4 The process of introducing license amendments is an important element of license conditions and/or may be subject to statutory constraints:
- a) It is desirable whenever possible that the Regulator and Licensee discuss proposed amendments [and that others are permitted to participate in this process] in an endeavor to reach consensus when it is necessary to amend the License.
 - b) However, in certain circumstances the Regulator may introduce amendments on its own motion without seeking consensus from the Licensee. These situations should be explicitly identified in the License and should be supported by statute. For example, amendments to make a license compliant with new laws adopted after license issuance.
 - c) Under any circumstances, the Licensee or other parties who are affected by the amendment should have a right to appeal the Regulator’s decision in court.

3. KEY ISSUES

- 3.1 A license which is difficult to amend may be more attractive to investors who want to reduce their financial risk in any emerging market economy which, by definition, has almost no experience with normal commercial practices or economic regulation of private companies.
- 3.2 The procedures and timeframe for license amendments need to be clearly established, especially during the transition period to the power market when uncertainty is predominant.
- 3.3 The Regulator bears the responsibility to adopt licenses and regulatory processes that balance investors’ needs for greater certainty and less risk with the

¹⁰ See Licensing Committee paper “*License Enforcement*”, December 1998.

Regulator's obligations to protect consumers in the future when changes in the industry or other external factors may signal a need for new rules.

4. ACTION STEPS

- 4.1 Whenever possible, efforts should be made to design license amendments that are acceptable by both the Regulator and Licensee, since changes which are agreed by both parties can be made at any time.
- 4.2 Since license changes potentially can affect many other parties (other licensees, consumers, etc.), amendments should be considered in a transparent, formal proceeding before the Regulator, with public notice and participation allowed for all interested parties. This process should be created by the Regulator.
- 4.3 License conditions should specify the limited circumstances, if any, under which amendments can be introduced by the Regulator without the consent of the licensee.
- 4.4 A dispute resolution process must be in place to resolve matters which cannot be agreed between the Regulator and the licensee or to protect the rights of third parties who may have interests affected by license changes, even when Regulator and licensee agree to a change. The decisions of the Regulator should be open to be appealed at court in accordance with the appropriate legislation.

REGIONAL ENERGY REGULATORY CONFERENCE FOR CENTRAL/EASTERN EUROPE & EURASIA

**Regulatory Actions to Limit or Correct Abuse
of Market Power**

December 1999

Licensing/Competition Committee Member Countries:

Armenia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic,
Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, and
Ukraine

Regulatory Actions to Limit or Correct Abuse of Market Power

1. INTRODUCTION

- 1.1. Economic regulation by state agencies is required in markets characterized as “natural” monopolies, i.e., markets where it is not practical or feasible for society to support more than one supplier of a good or service.
- 1.2. In energy markets today it is generally accepted that network services (transmission/transportation and distribution are natural monopolies, but that resource supply (e.g., electric generation) and supply to consumers (sales to end-users), which utilize the transportation networks to deliver energy, have the potential to become competitive businesses if the appropriate institutional framework is created.
- 1.3. However, even in markets with more than one generating resource or supplier, the existence of excessive market concentration (a few entities controlling most of the market) may mean that there are not enough competing firms to prevent prices from rising above a true competitive level and to keep the service quality at a good or acceptable level.
- 1.4. One of the responsibilities of the Regulator is to protect consumers from excessive prices and from any other potential abuse resulting from market power (such as service level, customer choice, etc.). Therefore the regulator must adopt policies and take decisions which encourage competitive markets, wherever possible, and guard against the exercise or emergence of monopoly power.
- 1.5. There are basically two types of market concentration of concern to policy makers:
 - a) *Horizontal market concentration* occurs when a single functional element in the supply chain from producer to consumer is dominated by too few potential service providers to assure competitive behavior (e.g., a power generation market with only 2 or 3 separate entities).
 - b) *Vertical concentration* occurs when a single firm owns all of the functional components reaching from production to supply to retail consumers.
 - c) In order to encourage the emergence of a more competitive market and prevent potential monopoly abuses, Regulators may need to impose ownership limitations among entities participating in energy markets to prevent both horizontal and vertical concentration.

2. MARKET POWER ISSUES IN THE ENERGY INDUSTRY

- 2.1. Countries have taken different approaches to the assignment of responsibility for monitoring and limiting the potential for monopoly power, including establishing a Competition Office or Antimonopoly Committee to address monopolies in the

economy as a whole and assigning specific objectives for energy regulators to promote competition and provide protection for consumers.

- 2.2. Regulators should consider the competitive affects of issuing energy licenses, denying licenses when issuance would result in excessive market power through horizontal or vertical concentration in competitive markets.
- 2.3. In large markets with many competing participants, the Regulator can usually rely on normal market forces to produce appropriate, market-driven prices. In smaller markets with fewer participants, the Regulator will be required to monitor market behavior and prices more closely, relying on data provided by licensees pursuant to reporting obligations embedded in license conditions and/or data regarding power market transactions as required in the approved market rules.
- 2.4. In addition to actual price behavior and service quality, the Regulator must also guard against the potential for future monopoly behavior resulting from merger or acquisition activities in the industry. Even where there are effective statutory or license prohibitions in place, there remains a need for Regulatory monitoring of compliance by the licensees.
- 2.5. Monitoring the ownership structure may include:
 - a) Requirements for the licensee to report the transfer of a controlling block (or perhaps concentrated ownership greater than X %) of the licensees' voting shares;
 - b) Copies of any share registration documents filed with the state agency regulating the sale or exchange of stocks;
 - c) Requiring the approval of the Regulator in cases when one licensee wants to purchase the shares of another or when a share transfer of greater than x% is proposed;
 - d) License termination and re-issuance upon change of business ownership;
 - e) Rules to enable the Regulator to discover both direct and in-direct ownership of the licensee;
- 2.6. The scope of data to be publicly disclosed in order to balance the competing objectives of commercial confidentiality (avoiding damage to business interests) and public transparency (keeping the public properly informed) must be carefully considered;
- 2.7. The Regulator's concerns about the potential lack of competition must be balanced against a need to avoid limitations on ownership that might become a barrier to attracting investment in the power sector. Some considerations are:
 - a) In order to create an investment environment with an acceptable level of market risk, the Regulator (or the legislation) needs to establish clear standards concerning ownership limitations with respect to business concentration and, through its consistent behavior, provide a certainty of application upon which investors can rely.

- b) Competition is not a goal in itself, but rather it is an effective tool to achieve lower production costs of electricity;
 - c) The major disadvantage of an ownership limitation is repelling potential investors, particularly on relatively small systems;
 - d) On some systems impeding private investment could do more damage to the sector than the potential exercise of excessive market power by one or more market participants;
 - e) With proper regulation the power sector can still operate efficiently even if the generating segment is not competitive.
 - f) If the regulator establishes transparent rules and regulatory mechanisms and adopts fair tariffs to encourage new players to enter the power sector, the conditions for competition will eventually emerge.
 - g) Clear rules set by legislation, government or regulator in advance could give easier result compared to ex-post regulatory actions.
 - h) There are examples, where the energy law contains some ownership limitations (such as less than 10% in generation in one hand, or independent system operator can not be owned by energy market player over 10 % each and 40% total) and there are regulatory practices, where the Regulator could force the licensee to sell ownership over some part of generation capacity.
- 2.8. The privatization process must be structured so that it does not adversely affect the Regulator's concerns and policies regarding monopoly and competition.
- a) The Regulator has a major, perhaps difficult, responsibility to keep the terms of any privatization consistent with the industry and regulatory framework adopted by the State, including such important issues as market concentration;
 - b) Any changes to existing forms of licenses or agency regulations that are proposed by potential investors in the privatization process should be carefully reviewed for their implications for the future best interests of the sector and consumers;
 - c) Regulators have a duty to oppose any terms of a privatization that would violate its basic statutory responsibilities, including in particular those relating to the promotion of competitive markets and providing protection to consumers;
- 2.9. Maintaining non-discriminatory access to the transmission/transportation system is critical to the creation of a competitive market. Regardless of ownership, the operation of the central dispatch system must be managed with sufficient independence as to insure equal and equitable access by all suppliers with no differential treatment. There are a number of management models, including state directed central dispatch or independent system operator, which can be designed to safeguard discriminatory access. At the same time, transmission owners must be fairly compensated for their investments.

3. KEY ISSUES

- 3.1. The Regulator's right and responsibility to address and remedy potential abuses of market power must rest upon solid statutory authority.
- 3.2. The Regulator may find it useful to coordinate its anti-monopoly activities with any other agencies of the government that are involved with determining or enforcing anti-monopoly policy.
- 3.3. An important threshold consideration for the Regulator is determining whether the competitive resource market is large enough to create a realistic competitive environment:
 - a) How many independent resource providers (power plant companies and others) are needed to create a "workably" competitive market?
 - b) If the number of suppliers is too small now, is this a transition problem or one which will exist for a long time?
- 3.4. In order to have an opportunity to create competition in the retail market, it is necessary first to have a competitive generating resource market.
- 3.5. The kind of license conditions which the Regulator can impose that would restrict a licensee (and its owners) from acquiring other entities and achieving a monopoly position include:
 - a) Prohibiting or limiting ownership of entities at different functional levels (generation, transmission, distribution and retail); and
 - b) Limiting market concentration in competitive, or potentially competitive, functions to some maximum share of market (e.g., say 20%).
- 3.6. Regulators should carefully consider how to balance the need to attract private investment against the policy objectives of minimizing monopoly power and encouraging competitive markets?
- 3.7. The emergence of competitive energy markets is more likely to be achieved if a careful, realistic plan is developed to address both immediate, short-term critical needs as well as the long-run vision of a fully mature energy sector.

4. ACTION STEPS

- 4.1. Regulatory policies and decisions should be guided by competition/monopoly market policies embedded in law generally or in the Regulator's own enabling statutes.
- 4.2. Regulatory policies must be country-specific, taking into consideration the relative size of the country-wide and/or potential regional energy market and the limitations that scale economies place on the number of commercially viable businesses which the country's economy is capable of supporting.

- 4.3. Initial license conditions are a useful tool to implement policy by imposing size or scope limitations on energy sector licensees which help to control market power now and prevent problems in the future.
- 4.4. Arbitrary restrictions on size or ownership of industry assets (whether in law or licenses) should be carefully developed to assure that sound policy goals do not conflict with the near-term, critical participation by strategic private investors in the energy sector.

REGIONAL ENERGY REGULATORY CONFERENCE FOR CENTRAL/EASTERN EUROPE & EURASIA

**Limits on the Scope of Issues within the Authority
of Energy Regulators**

December 1999

Licensing/Competition Committee Member Countries:

Armenia, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic,
Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, and
Ukraine

Limits on the Scope of Issues within the Authority of Energy Regulators

1. INTRODUCTION

- 1.1. Prior to reforms of the energy systems in the CEE and NIS countries, all matters relating to energy were managed and supervised by one integrated governmental authority.
- 1.2. With the change to an unbundled, privatized industry operating in a commercial market environment, the State's regulation of the various activities of energy companies is reduced substantially on the one hand, but becomes more complex on the other due to the new jurisdictional boundaries which need to be created between the industry, State agencies and the new Energy Regulator.
- 1.3. The most capable and competent entity emerging in many countries as a result of energy industry restructuring is the Energy Regulator with its focus on the new economic, service quality and consumer protection issues which emerge during the transition to commercial operations with private investor ownership.
- 1.4. However, there are certain activities, which require State supervision to protect vital public interests that apply not only to the energy sector but also to a broad spectrum of other industries and, significantly, do not involve any expertise in economic regulation.
- 1.5. Since the principal focus and purpose of the Energy Regulator is to supervise activities related to the adequacy, reliability, quality and price of energy services, the Regulators involvement in aspects of State supervision unrelated to its central mandate should be left to other agencies in most cases.

2. THE SCOPE OF AUTHORITY OF ENERGY REGULATORY AGENCIES AS RELATED TO OTHER GOVERNMENT BODIES

- 2.1. In order to keep the Energy Regulator focussed on matters directly related to securing energy supplies with an acceptable quality of service and at reasonable prices, it would be advisable if separate State authorities, and not the Energy Regulator handled issues such as the following:
 - a) Technical requirements for the location and construction of facilities used to perform licensed activities;
 - b) Technical safety of power plants;
 - c) Technical requirements for distribution facilities (wiring, etc.) and equipment located on customer premises;
 - d) Public and worker safety standards;

- e) Environmental protection¹¹;
 - f) Strategic energy policy issues.
- 2.2. Countries have adopted different State structures to address these kinds of issues that lie outside of the Regulator's concerns about economic behavior and consumer protection. How the State organizes these matters is beyond the scope of regulatory concern.
- 2.3. Environmental protection issues are normally within the jurisdiction of other State agencies. However, it is often appropriate for the Energy Regulator to consider environmental issues when setting its policy or deciding issues related to:
- a) Energy sector development;
 - b) New energy resources;
 - c) Construction of new generation;
 - d) Transmission and distribution facilities;
 - e) Other matters affecting the environment;
- 2.4. The Energy Regulator should have authorities and powers to encourage the energy efficiency policy adoption by the management of the energy companies.
- 2.5. The worldwide restructuring of energy industries is characterized by an approach to energy regulation that encourages reliance on market forces to diminish the need for regulatory intervention in the energy business. The idea is to establish competitive markets to the maximum extent feasible and rely on market forces to control outcomes for consumers, together with exercising the least amount of supervision over the remaining monopoly businesses necessary to protect consumers from any attempts to improperly exercise market power. It is evident that energy markets are evolving over time and that greater oversight by regulators during the transition might be required to encourage market development.
- 2.6. Regulators must resist the urge to over-regulate but should develop appropriate responses to developing markets. These responses can be temporary, until the market forces develop. Further, the regulator may have to develop new process to deal with emerging market issues quickly and efficiently.

3. KEY ISSUES

- 3.1. The primary focus for energy regulation should be industry economic issues, quality of service provided and the protection of consumers interests, which focus on the operations and performance of the companies as service providers.

¹¹ The Energy regulator should work in close harmony with environmental and other authorities.

- 3.2. Many public policy issues addressed by the State affect the behavior of businesses generally, not just the energy sector, and in most cases would not, or should not, fall within the responsibility of the Regulator.
- 3.3. Some matters, even though they are specific to energy, are better left to the expertise of other agencies (e.g., air pollution from thermal generators).
- 3.4. For many of the issues which do fall within the bounds of the energy sector (and are not within the jurisdiction of other State agencies), the appropriate role of the regulator is to review and approve standards which are developed and agreed directly by the energy companies (e.g., establishing technical standards for billing meters and meter test procedures or administrative processes for disconnection of customers due to non-payment).

4. ACTION STEPS

- 4.1. The relationships between State authorities for technical safety, environmental protection, system security questions and the Regulator need to be considered carefully by all affected parties and then clear rules and boundaries of authority established.
- 4.2. As a general guide to the scope of activities which should be undertaken by Regulators, it would be useful to remember:
 - a) As energy markets develop more of the characteristics of open, free and vigorously competitive markets, then the scope and nature of activities required from Energy Regulators will change;
 - b) Even in competitive markets businesses must comply with a wide variety of regulations governing their activities – but basic market behavior and value for money is determined by competition for the consumer's business.
 - c) The primary purpose of energy regulation is to represent the public interest (specifically for the protection of consumers against the potential for harm resulting from an abuse of market power) in segments of the energy market where there is no competitive pressure to rely on to discipline the behavior of providers with respect to consumer prices and service.
- 4.3. Issues which are not related to energy economics, market behavior, service quality and other consumer service issues should not be undertaken by Energy Regulators unless, after careful study and for very compelling reasons, it is concluded that the special expertise of the Regulator is required.
- 4.4. The scope of the Energy Regulator's responsibilities should be determined by law, as well as the jurisdiction of other State regulatory agencies.

A study of the development and designation of assigned responsibilities to various State agencies among some of the more mature market economies may provide useful guidance for developing specific recommendations for State policy.